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SUBJECT: KOCHARIAN SCOLDS TAX AND CUSTOMS OFFICIALS

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SUMMARY

¶1. (U) President Kocharian took an unusually hard stance with Customs and Tax officials during an annual January meeting with key government officials. He said the tax and customs services lacked the will to combat the shadow economy and described their work as "unsatisfactory." Despite some successful reforms and growing state revenues, the tax collection to GDP ratio remains low in Armenia, at less than 16 percent. The President also warned tax and customs officials to steer clear of politics during upcoming parliamentary elections scheduled for May 2007. END SUMMARY

HARD WORK NEEDED TO MEET STATE BUDGET TARGETS

¶2. (U) For the third year in a row, Kocharian strongly criticized the tax and customs services at a January meeting of key government officials, including the Prime Minister Andranik Margarian, the Finance and Economy Minister, the Heads of Customs Committee and Tax Service, and the National Police Chief. Kocharian reminded tax and customs officials that the 2007 State Budget assumes a significant increase in revenues (12.3 percent higher than 2006 approved receipts). Tax and stamp duties are expected to account for 93.6 percent of total revenues, an increase of more than 20 percent from 2006 levels.

ARMENIA'S LOW TAX/GDP RATIO

¶3. (U) Despite active reforms in tax and customs administration, and considerable improvement in tax revenues in recent years, Armenia's tax to GDP ratio of 16 percent remains one of the lowest in the former Soviet Republics. For example, according to the IMF, the tax to GDP ratio for Georgia is 19.8 percent, for Ukraine 19.4 percent and for Russia 36.3 percent.

MORE REFORM IN THE WORKS

¶4. (SBU) The donor community has identified the need to improve tax to GDP ratios as a priority for Armenia. With significant support from the USAID-funded Armenia Tax Improvement Program (ATIP), the

Armenian tax service has developed a new three-year strategic plan for tax administration which is scheduled to be finalized in late-January. The Chief of Party of ATIP told us that the President's remarks would benefit reform and that the President's office has become increasingly aggressive in pushing for reform, not only publicly, but also on a semi-weekly basis at the working level.

LET'S KEEP POLITICS OUT OF IT

15. (SBU) The President also strongly and publicly warned tax and customs officials to have "no connection whatsoever" with the May 2007 parliamentary elections. Kocharian added that the quality of tax and customs services must not be influenced by pre-election politics. Recent changes in Armenian legislation allow senior civil servants, including tax officials, to affiliate with political parties. Some observers worry that senior tax officials may join the ruling Republican Party or other influential political factions, compromising the integrity of their official positions.

COMMENT:

16. (SBU) American businesses consistently cite tax and customs administration as one of the most challenging aspects of working in Armenia. Political will is essential to combating the endemic problem of corruption in the notorious tax and customs services. While it is good that the President is willing to be so publicly critical of these agencies, it was not clear whether Kocharian's statement was merely pre-election campaign P.R. or a more specific warning not to choose sides in intra-elite power politics. The impact of his comments, if any, has yet to be determined. Similar anti-corruption "woodshed" meetings in previous years have had a modest impact at best, but have generally been less sharply worded. In this election season, the president might have greater than usual

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incentive to keep his senior revenue agency bureaucrats out of political mischief.

GODFREY